2.12 RECENT TRENDS IN AUDITING

Management audit

Management audit is a new concept in auditing. Area of Management audit is beyond conventional audit; it reviews all aspects of management. It is an audit of overall performance of management. It covers planning, organizing, co-ordination and control, etc. Management audit detects and diagnoses the problem and suggests various means to avoid and solve the problems.

Need of Management Audit

These days, reports on matters of policies and their implementation is very important to improve the efficiency of the management. Management Auditors advise the management on various matters related to performance of various departments as well as of the organization as a whole. Management Auditors may or may not be any finance and accountancy person. Management Auditors evaluate the actual performance by comparing it with predetermined standards. Auditors reveal any kind of defect and irregularities in the working of management. It can be said management audit helps in improving the performance and efficiency of management.

Objectives of Management Audit

- It helps management in setting sound and effective targets.
- To suggest management to obtain desired results and to reveal any defect and irregularities in the process of management.
- Management audit help in effective discharge of their duties.
- To help in co-ordination of various department.
- To help in training of personnel and marketing strategies.
- To compare input with outputs.
- To ensure strong relations with outsiders.
- To ensure most efficient internal organization.

Advantages of Management Audit

- It is helpful in making plan, objectives and policies of the management.
- It is helpful to efficiently achieve the set objectives of the management by coordinating with the personnel.
- It is very helpful to create strong communication system with outsiders and within the various departments.
- It is helpful to evaluate the performance of management.
- To establish good relations with employees.
- To elaborate duties, rights and liabilities of staff members and to make market strategies.
- It is helpful in preparation of budgets of organizations.
- It is helpful in preparation of budgets.
- It is helpful in resource management.

Appointment of Management Auditors

This team has experts with expertise in different fields of Management. Management audit team coordinates with the other levels of management and runs a smooth audit process. It is a team of experts with full knowledge about management science. Most of the team members have practical working experience of being a part of management. Such experience helps them handle actual work situations in a better way.

Qualities of Auditor

Following are a few important qualities of a Management Auditor —

- Good knowledge and experience of Managerial functions.
- An Auditor should have good knowledge of the financial statements analysis techniques.
- Knowledge of social accounting.
- Knowledge of human resource accounting.
- Good knowledge about economics and business laws, etc.
- Understanding about the working of organization and its problems.
- An Auditor should have sound knowledge of preparation and understanding about financial statements.
- He should know and understand the objectives of organization very well.
- He should understand about planning, budgets, rules and procedures to be applied in management.
- He should be well-versed with the entire production process.
- He should have enough knowledge and experience to understand the reason behind the lack of co-ordination between different departments.
- He should have the quality to give practical and achievable solutions instead of providing bookish suggestions.

Scope of Work of Management Audit

It is not possible to define complete working of management audit and the scope of work and the areas covered by management audit. Following are a few important areas covered by Management Audit—

- Administration
- Sales Management
- Purchase Management
- Distribution Management
- Stores and Inventories Management
- Production Management
- Personnel Management
- Finance and Accounts Management
- Management Information System
- Advertisement and Sales promotion

Management Audit Program

Audit Program means the planning of the outlines for the whole process and procedures of management audit from the beginning to the end. Following examples depict the outline of an Audit Program —

- Study about the organizational structure.
- Study to see whether the principles of a good organization have been followed or not.
- Detailed discussion with the top management about the objectives and the plans.
- Study of current policies adopted to achieve the desired objectives and also to study if there is any chance to improve them for better results.
- To decide the area of improvement whether it is planning or its implementation or both.
- Recommendations for improvements.
- To study whether the control system of an organization is adequate and effective.

- Study of the manufacturing process to locate the factors which are hindering the maximization of production.
- Study of personnel departments about policies, training, motivational schemes adopted currently for employees of the organization and what can be done further to improve the relations between employees and department.
- Study about the optimum utilization of the space available and also of the physical equipment.

Audit Report

The report submitted by an Auditor should give true and correct assessment of the working of the organization and should contain suggestions for improvements as required in management policies, procedures or any other area. He should not hesitate in criticizing the management but on the other hand his report should not be merely condemning in nature. Although there is no fixed Management Auditor Report as per statute but still an Auditor should cover the following areas in his report ?

- An Auditor should also see whether the relations between staff members and the management is healthy or nor. He should also highlight the areas of weakness and the suggestions for improvement, if any.
- About Methods and procedures of production.
- About operating efficiency.
- About rate of return on investment.
- About return to shareholders whether adequate or not.

Criticism of Management Audit

In spite of the various advantages of management audit in modern business world, it has faced criticism too

- According to managers and accountant it is just a vague concept which serves no material purpose at all.
- Management Auditors usually pin point shortcomings of managers in action, therefore they hesitate to take initiative.
- Normal practice of managers is to keep their record up to date instead of improving efficiency and reducing costs.

Cost Audit :

It is an audit process for verifying the cost of manufacture or production of any article, on the basis of accounts as regards utilisation of material or labour or other items of costs, maintained by the company. In simple words the term cost audit means a systematic and accurate verification of the cost accounts and records and checking of adherence to the objectives of the cost accounting.

As per **ICWA London**' "cost audit is the verification of the correctness of cost accounts and of the adherence to the cost accounting plan."

The **ICWAI** defines cost audit as "system of audit introduced by the government of India for the review, examination and appraisal of the cost accounting records and attendant information required to be maintained by specified industries"

Objectives of Cost Audit

The following are some of the objectives for which cost audit is under taken:

1. To establish the accuracy of costing data. This is done by verifying the arithmetical accuracy of cost accounting entries in the books of accounts.
2. To ensure that cost accounting principles are governed by the management objectives and these are strictly adhered in preparing cost accounts.
3. To ensure that cost accounts are correct and also to detect errors, frauds and wrong practice in the existing system.

4. To check up the general working of the costing department of the organization and to make suggestions for improvement.
5. To help the management in taking correct decisions on certain important matters i.e. to determine the actual cost of production when the goods are ready.
6. To reduce the amount of detailed checking by the external auditor if effective internal cost audit system is in operation.

Advantages of Cost Audit:

To The Management

1. Cost audit helps in detection of errors and frauds.
2. The management gets accurate and reliable data based on which they can make day-to day decisions like price fixation.
3. It helps in cost control and cost reduction.
4. It facilitates the system of standard costing and budgetary control.
5. It helps the management in inter-unit / firm comparison.
6. It enables the management to identify loss making propositions.

To The Government

1. Cost audit ensures efficient functioning of the industry. This in turn, nurtures a healthy competition among the different companies and paves a path for fast progress.
2. It helps in identification of sick units and enables the Government to make relevant decisions.
3. It helps in fixing prices in the case of essential commodities and checking undue profiteering.
4. It enables to take decisions as to granting of subsidies, incentives and protection to various industries.
5. It helps to take decisions as to levies, duties and taxes.

To the Society

1. Cost audit enables the Government to fix prices of essential commodities. This safeguards the interests of the society.
2. Cost audit enables the Government to keep a check on undue profiteering by the manufacturers and avoids artificial price rise due to monopolistic tendencies.

To the Shareholders

1. Cost audit reveals whether any of the products of the company are making losses. Thus though the company making an overall profit, a loss making line may eat up the company's profits. This is brought to the notice of the shareholders and the management is forced to take remedial measures, thereby making optimum utilisation of resources.
2. Cost audit ensures that the shareholders get a fair return on their investments.

Disadvantages of Cost Audit:

1. Holding a Cost Audit can be expensive. This is because a company will often bring in an independent auditor who are normally charging higher price.
2. A Cost Audit can be a long process which will likely involve more time. This extra time and effort can impact an employee's day to day routine work.
3. If a Cost Audit is carried out in order to find fraudulent activity it can take a long time by which time people stealing could have covered their tracks.
4. Cost Audits involve a large amount of estimation and so there is the possibility that figures will be incorrect and if record keeping from the company is not good to start with then inaccuracies will be arises.

Financial statement audit

A financial statement audit is the examination of an entity's financial statements and accompanying disclosures by an independent auditor. The result of this examination is a report by the auditor, attesting to the fairness of presentation of the financial statements and related disclosures. The auditor's report must accompany the financial statements when they are issued to the intended recipients.

The purpose of a financial statement audit is to add credibility to the reported financial position and performance of a business. The Securities and Exchange Commission requires that all entities that are publicly held must file annual reports with it that are audited. Similarly, lenders typically require an audit of the financial statements of any entity to which they lend funds. Suppliers may also require audited financial statements before they will be willing to extend trade credit (though usually only when the amount of requested credit is substantial).

Audits have become increasingly common as the complexity of the two primary accounting frameworks, Generally Accepted Accounting Principles and International Financial Reporting Standards, have increased, and because there have been an ongoing series of disclosures of fraudulent reporting by major companies.

The primary stages of an audit are:

1. **Planning and risk assessment.** Involves gaining an understanding of the business and the business environment in which it operates, and using this information to assess whether there may be risks that could impact the financial statements.
2. **Internal controls testing.** Involves the assessment of the effectiveness of an entity's suite of controls, concentrating on such areas as proper authorization, the safeguarding of assets, and the segregation of duties. This can involve an array of tests conducted on a sampling of transactions to determine the degree of control effectiveness. A high level of effectiveness allows the auditors to scale back some of their later audit procedures. If the controls are ineffective (i.e., there is a high risk of material misstatement), then the auditors must use other procedures to examine the financial statements. There are a variety of risk assessment questionnaires available that can assist with internal controls testing.
3. **Substantive procedures.** Involves a broad array of procedures, of which a small sampling are:
   - **Analysis.** Conduct a ratio comparison with historical, forecasted, and industry results to spot anomalies.
   - **Cash.** Review bank reconciliations, count on-hand cash, confirm restrictions on bank balances, issue bank confirmations.
   - **Marketable securities.** Confirm securities, review subsequent transactions, verify market value.
   - **Accounts receivable.** Confirm account balances, investigate subsequent collections, test year-end sales and cutoff procedures.
   - **Inventory.** Observe the physical inventory count, obtain confirmation of inventories held at other locations, test shipping and receiving cutoff procedures, examine paid supplier invoices, test the computation of allocated overhead, review current production costs, trace compiled inventory costs to the general ledger.
   - **Fixed assets.** Observe assets, review purchase and disposal authorizations, review lease documents, examine appraisal reports, recalculate depreciation and amortization.
   - **Accounts payable.** Confirm accounts, test year-end cutoff.

- **Accrued expenses.** Examine subsequent payments, compare balances to prior years, recompute accruals.
- **Debt.** Confirm with lenders, review lease agreements, review references in board of directors minutes.
- **Revenue.** Examine documents supporting a selection of sales, review subsequent transactions, recalculate percentage of completion computations, review the history of sales returns and allowances.
- **Expenses.** Examine documents supporting a selection of expenses, review subsequent transactions, confirm unusual items with suppliers.

An audit is the most expensive of all the types of examination of financial statements. The least expensive is a compilation, followed by a review. Due to its cost, many companies attempt to downgrade to a review or compilation, though this is only an option if it is acceptable to the report recipients. Publicly held entities must have their quarterly financial statements reviewed, in addition to the annual audit.

ENERGY audit

- Energy Audit is a periodic examination of an energy system to ensure that energy is being used as efficiently as possible.
- Energy audit is a top-down initiative its result depends on the resources being allocated by top management.
- In many ways, an energy audit is similar to financial accounting and auditing.

Advantages of Energy Audit

Through energy audit, you can:

- Promote awareness in energy efficiency
- Identify the cost of energy you use
- Identify and minimize wastage
- Making changes to procedure, equipment and system to save energy.
- Retrofit energy efficiency technologies
- Conserve non-renewable energy resources
- Protect the environment by reducing power generation
- Reduce running costs

Conducting An Energy Audit

OUTLINE

- Initiating an Energy Management Program
- Goals of the Energy Audit
- Energy Bills
- Steps in the On-Site Energy Audit
- Degree Days, Layout, Operating Hours
- Equipment List
- Systems to Consider
- Energy Audit Report

Goals of the Energy Audit are to:

- Clearly identify types and costs of energy use
- Understand how that energy is being used and possibly wasted
- Identify and analyze more cost-effective ways of using energy

- improved operational techniques
- new equipment

- Perform an economic analysis on those alternatives and determine which are cost-effective for your business or industry

Steps in the On-site Energy Audit

1. Identify layout and operating schedule for facility.

Make a plan or sketch of the building(s) which shows building size, room sizes, window areas, and wall and roof composition and insulation (offices, prod, maint,...)

2. Compile an equipment inventory.

List all energy consuming equipment, with hours of use each year and energy ratings or efficiencies.

3. Determine the pattern of building use to show annual needs for heating, cooling, & lighting.

4. Conduct a room-by room lighting inventory

- light fixtures
- lamp types, sizes and numbers
- levels of illumination
- uses of task lighting

The Energy Audit Report

- The energy audit report details the final results of the energy analyses and provides energy cost saving recommendations.
- The length and detail of this report will vary depending on the type of facility audited.
- A residential audit may result in a computer printout from the utility.
- An industrial audit should have a detailed explanation of the EMO's and benefit-cost analyses.

Energy Audit Report Format

- Executive Summary

  Brief summary of recommendations and cost savings
- Table of Contents
- **Introduction**
  - Purpose of the energy audit
  - Need for a continuing energy cost control program
- **Facility Description**

Product or service, and materials flow Size, construction, facility layout, and hours of operation, Equipment list, with specifications

- **Energy Bill Analysis**

Utility rate structures

Tables/graphs of energy consumptions and costs

Discussion of energy costs and energy bills

- **Energy Management Opportunities**

Listing of potential EMO's

Cost and savings analysis

Economic evaluation

- **Energy Action Plan**

Recommended EMO's and an implementation schedule

Designation of an energy monitor and ongoing program

- **Conclusion**

Additional comments not otherwise covered

Environment audit

Environmental audit is defined as basic management tool which comprises a systematic, documented, periodic and objective evaluation of how well organization, management systems and equipments are performing.

- A good environment management policy requires that there should be a constant effort to analyze and monitor various industrial working system and processes to generate and transmit this information for the inspecting authority such as exercise which generates necessary information on analysis of pollution being generated or will be generated and completion of annual estimate has been termed as environmental audit.
- Generally following are the 3 phases when an environmental audit is taken up for an industry:
  - o phase: Preaudit activity- pertaining to collection of information.
  - o phase: Activity at site pertaining to evaluation of information collected.
  - o phase: Post audit activity pertaining to drawing conclusion and identifying areas of improvement if any.

Objectives:

- Environment audit needs for an industry are internal as well as external value
- External needs serve to achieve compliance standards and establish a report with regulatory bodies for implementation of environment management policies.
- Internal need serves the industry as well as self evaluation tool for the process and technology.
- It helps in pollution control, improves production safety and health conservations of nocturnal resources by the way of ensuring waste prevention and reduction, assessing compliance with regulatory requirement, placing environmental information to the public.

Advantages:

- EA report provides the necessary information on how well the management systems are performing to keep place with sustainable level of development.
- It provides performance evaluation of industrial working facilities and its possible effect in the surrounding.
- It refers to compliance with local, regional and national laws and regulation
- Potential areas for reduction in raw material consumption leads to cost saving
- Provide an upto date environmental data to the inspecting authority.

Steps for EA Audit

- The International Chamber of Commerce presents the different steps of an EA as follows:
- **Pre-audit activities:** which include:
  - Selection and scheduling of facility to audit,
  - Selection of audit team.
  - Contact with facility and planning of the audit.
- **Site activities:** which are divided into 5 steps:
  - First understanding of internal controls,
  - Assessment of internal controls,
  - Gathering of audit evidence,

- Evaluation of audit findings,
- Report of findings to facility.

- **Post audit activities:** which include:
  - Production of a draft report,
  - Production of a final report,
  - Preparation and implementation of an action plan,
  - Monitoring of action plan.

Scope of EA

1. **Material Audit :** The thrust areas of material audit is the effective utilization of materials, conservation of materials and minimizing wastages in different processes.
2. **Energy Audit :** It deals with overall energy consumption, minimizing pollution etc.
3. **Water Audit :** Evaluation of raw water intake facilities and evaluation of water treatment facilities.
4. **Health and Safety Audit :** Health and safety measures are examined e.g. occupational diseases, compliance with labour laws. Adequacy of Safety measures etc.
5. **Environmental Quality Audit:** It examines noise level, status of existing air quality, review of greening program undertaken by the enterprise. Installation and functioning of anti pollutant equipment.
6. **Water Disposal Audit :** Review of waste disposal measures relating to solid and hazardous wastes, recycling etc.
7. **Engineering Audit :** It analyses the aspect relating to efficiency of plant and machinery, engineering designs, cost effective methods of production etc.

Benefits

Facilitating comparison and interchange of information between operation or plants,

Increasing employee awareness of environmental policies and responsibilities,

Identifying cost-savings including those resulting from waste minimization,

Evaluating training programmes and providing data to assist in training personnel,

Providing an information base for use in emergency response arrangements,

Assuring an adequate, up-to-date environmental database for internal management awareness and decision making in relation to plant modifications, new plans, etc.,

Helping to assist relations with authorities by convincing them that complete and effective audits are being undertaken, by informing them of the type of procedure adopted

Environmental Audit : Indian Status

In India there is no Statutory requirement for EA in Corporate sector or in the Government sector.

Few private sector companies like TISCO,ITC are periodically conducting EA.

In India a procedure for EA was first notified under the Environment Protection Act in 1986 by the Ministry of Environment of Forests.

This notification requires submission of an “Environmental Audit Report" or statement to the concerned state Pollution Board.

As per the Indian Companies Act, 1956, details relating to energy consumption/energy conservation are presented in the Director's Report as annexure and it highlights the environment related policies problems.

FOR AUDIT REPORT

The major differences between JIT manufacturing and traditional manufacturing are as follows:

	JIT		Traditional
1	Pull system	1	Push system
2	Insignificant or zero inventories	2	Significant inventories
3	Manufacturing cells (work centres)	3	Process structure
4	Multifunction labour	4	Specialised labour
5	Total quality management (TQM)	5	Acceptable quality level (AQL)
6	Simple cost accounting	6	Complex cost accounting